

VIII. PARTIES RESPONSIBLE FOR VIOLATIONS OF LAW: WASTEWATER

The facts demonstrate that various individuals employed at some of the highest levels of City government caused the City to violate the Clean Water Act and possibly Prop 218, placed the City in breach of hundreds of millions of dollars in grant and loan agreements, and then concealed these significant matters from the investing public. The principal actors are discussed individually below and their individual culpability is assessed based on their respective knowledge, their responsibilities, and what actions they took or failed to take.

A. Mayor and City Council

Mayor Murphy and a majority of the members of the City Council are responsible for the City's violations of the Clean Water Act, possibly Prop 218, and the City's grant and loan agreements, and the subsequent concealment of those violations from the investing public. Each Council members' individual culpability for causing the City to violate laws and its contractual obligations is discussed separately below.

On January 29, 2002, Mayor Murphy and Council members Madaffer, Wear, Maienschein, Atkins, Frye, and Stevens were told that: (a) the City's sewer rate structure did not allocate the costs of providing service proportionally among users and therefore violated the Clean Water Act; and (b) as a result, the City had violated its covenants in connection with hundreds of millions of dollars of grants and loans.⁸⁷³ The City was close to completing a COSS, and had completed another years before. Council members were also told the necessary change would have reduced the sewer bills for a vast majority of San Diegans, and increased the sewer rates for certain large commercial users.⁸⁷⁴ Nonetheless, the Mayor and City Council made the decision to permit the City of San Diego to remain in violation and force its residents to continue subsidizing the rates of its businesses. Mayor Murphy responded to the news that the City was violating the law by asking whether the State had made any demands that the City comply with the law – in other words, he wanted to know whether the City's violation had been detected. Councilmember Madaffer commented, "Let 'em sue us."⁸⁷⁵ Over the objections of Councilmembers Frye and Stevens, the City Council then voted to

⁸⁷³ E-mail from Les Girard to Dennis Kahlie (Apr. 15, 2004); Dennis Kahlie, Salient Points, Sewer Cost of Service Compliance Issue at 3 (Nov. 13, 2002); Interview by the Audit Committee with Dennis Kahlie (Oct. 18, 2005). Councilmember Peters was not present for this Closed Session presentation. City of San Diego City Council Closed Session Report (Jan. 29, 2002).

⁸⁷⁴ Dennis Kahlie, Salient Points, Sewer Cost of Service Compliance Issue, at 3 (Nov. 13, 2002); Interview by the Audit Committee with Dennis Kahlie (Oct. 18, 2005).

⁸⁷⁵ E-mail from Les Girard to Dennis Kahlie (Apr. 15, 2004); E-mail from Jim Madaffer to Dennis Kahlie (Jan. 29, 2002).

“note and file” the matter, effectively tabling the issue.⁸⁷⁶ The Council also directed the City Attorney to “analyze” the matter, which analysis took nearly an entire year to complete.⁸⁷⁷

The City Attorney’s analysis yielded an unequivocal conclusion. The City Attorney told the Mayor and City Council that the City “has not been in compliance with Clean Water Act standards for its user charge system through much of the time it has been receiving the Clean Water grants and loans.”⁸⁷⁸ The legal memorandum warned, “[i]f the City does not proceed, it risks losing its SRF loans, which would have a severe and immediate impact on the City’s budget”⁸⁷⁹ The City Attorney quantified the potential consequences of the City’s continued violation, stating that the State could demand repayment of “approximately \$370 million in Clean Water grants and SRF loan monies.”⁸⁸⁰ The Mayor’s office also received Kahlie’s Salient Points Memo, which stated the SWRCB had been “under the mistaken impression” that the City was in compliance, but had now “made it clear on numerous occasions that the City’s current rate structure is not in compliance and that the City has exhausted the SWRCB’s patience.”⁸⁸¹

After receiving a formal legal opinion setting forth the City’s potential liability for its violation, the Mayor and City Council continued to falter. Although the City Council was scheduled to address the City Attorney memorandum in closed session on November 19, 2002, the matter was removed from the agenda and two more years of “study” followed. During that time, the City applied for an additional loan valued at over \$12 million while in knowing violation.⁸⁸²

There is evidence the delays in bringing forward a compliant rate structure resulted directly from pressure on the Council by industrial users. For example, Kelco representative David McKinley wrote a letter in August 2003 describing Kelco’s goal “to maintain the status quo” for sewer rates.⁸⁸³ He stated that the prior year, Kelco had “received help from Councilmember Byron Wear. He championed the issue, and

⁸⁷⁶ City of San Diego City Council Closed Session Report (Jan. 29, 2002).

⁸⁷⁷ Memorandum from Mary Vattimo, City Treasurer, and Kelly J. Salt, Deputy City Attorney, to Honorable Mayor and City Council (Nov. 14, 2002); City of San Diego City Council Closed Session Report (Jan. 29, 2002).

⁸⁷⁸ Memorandum from Mary Vattimo, City Treasurer, and Kelly J. Salt, Deputy City Attorney, to Honorable Mayor and City Council (Nov. 14, 2002).

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⁸⁸⁰ Memorandum from Mary Vattimo, City Treasurer, and Kelly J. Salt, Deputy City Attorney, to Honorable Mayor and City Council (Nov. 14, 2002).

⁸⁸¹ Dennis Kahlie, Salient Points, Sewer Cost of Service Compliance Issue, at 3 (Nov. 13, 2002).

⁸⁸² San Diego Environmental Lab Project, Loan No. C-06-4703-110 (approved Feb. 26, 2003).

⁸⁸³ Letter from David McKinley, Mgr., Environmental, Safety & Health, International Specialty Products, Inc., to Larry Dolson, Business Representative, Operating Engineers Local 501 (Aug. 4, 2003).

persuaded all the Council members except Donna Frye to vote in closed session to table the study indefinitely, along with COD charges. So we have a history of council support.”⁸⁸⁴ Evidence from other non-elected officials corroborates the conclusion that the City Council intentionally delayed implementing a compliant rate structure out of concern for Kelco.⁸⁸⁵

When asked about these events, the members of the City Council had little to no recollection about them. No Council member who was asked by the Audit Committee could recall the substance of the City Attorney’s memorandum or why the matter was removed from the closed session agenda in November 2002.⁸⁸⁶ Council members Maienschein, Atkins, and Stevens recalled the January 29, 2002 closed session, but none had an accurate recollection of the substantive issues discussed during it.⁸⁸⁷ Even when shown his e-mail to Dennis Kahlie commending Mr. Kahlie for “sticking to your position” and asserting that they “can’t say we weren’t given a fair warning,” Councilmember Madaffer could not recall being told that the City was required to change its sewer rate structure, stating that he recalled his resistance was to a sewer rate increase.⁸⁸⁸ Mayor Murphy was the only elected official who stated that he recalled the “hostile” response to Mr. Kahlie’s January 29, 2002 closed session presentation, the November 14, 2002 Memo, and Mr. Kahlie’s Salient Points Memo.⁸⁸⁹ He candidly acknowledged that he understood the City was in violation and was continuing to receive SRF loans notwithstanding that fact, but explained that modifying the rate structure was “controversial,” and he therefore wanted to delay it until after an upcoming water rate increase.⁸⁹⁰ He stated that, notwithstanding the admonitions, he did not believe the State would ever demand acceleration of the loans.⁸⁹¹

⁸⁸⁴ Letter from David McKinley, Mgr., Environmental, Safety & Health, International Specialty Products, Inc., to Larry Dolson, Business Representative, Operating Engineers Local 501 (Aug. 4, 2003).

⁸⁸⁵ Interview by the Audit Committee with Bill Hanley (Apr. 25, 2006); Interview by the Audit Committee with David Schlesinger (Apr. 24, 2006); Interview by the Audit Committee with Dennis Kahlie (Oct. 18, 2005).

⁸⁸⁶ Interview by the Audit Committee with Councilmember Brian Maienschein (May 12, 2006); Interview by the Audit Committee with Councilmember Donna Frye (May 3, 2006); Interview by the Audit Committee with Councilmember Scott Peters (May 1, 2006); Interview by the Audit Committee with Councilmember Toni Atkins (Apr. 28, 2006); Interview by the Audit Committee with Councilmember George Stevens (Apr. 24, 2006).

⁸⁸⁷ Interview by the Audit Committee with Councilmember Brian Maienschein (May 12, 2006); Interview by the Audit Committee with Councilmember Toni Atkins (Apr. 28, 2006); Interview by the Audit Committee with Councilmember George Stevens (Apr. 24, 2006).

⁸⁸⁸ E-mail from Jim Madaffer to Dennis Kahlie cc to Michael Uberuaga (Jan. 29, 2002); Interview by the Audit Committee with Councilmember James Madaffer (Apr. 27, 2006).

⁸⁸⁹ Interview by the Audit Committee with Mayor Richard Murphy (May 2, 2006).

⁸⁹⁰ Interview by the Audit Committee with Mayor Richard Murphy (May 2, 2006).

⁸⁹¹ Interview by the Audit Committee with Mayor Richard Murphy (May 2, 2006).

The Mayor and City Council deliberately concealed from its citizens both the City's knowing violation of law and just as troubling, the fact that the violation resulted in San Diego's residents largely footing the sewage bill for the industrial class. These facts were relegated to closed session discussions only, notwithstanding Councilmember Frye's repeated efforts to bring the matters to the public's attention. These facts demonstrate that Mayor Murphy and Council members, Atkins, Maienschein, Madaffer, Inzunza, and Peters knowingly and improperly caused the City to violate federal and state law, and the conditions of its grants and loans.⁸⁹²

B. City Manager's Office

City Manager Michael Uberuaga and Deputy City Managers George Loveland and Patricia Frazier also share significant blame for causing the City to violate the Clean Water Act, possibly Prop 218, and its loan and grant covenants. Ms. Frazier knew of the City's violations since at least July 1997, when she authored a memo discussing the fact that the City retained Pinnacle to conduct a COSS in order to bring the City into compliance.⁸⁹³ The Pinnacle COSS was completed in May 1998 and confirmed that changing the City's sewer rate structure was a mandatory condition for receipt of Clean Water Act grants.⁸⁹⁴ It never saw the light of day, however. In the fall of 1999, when Councilmember Christine Kehoe asked about a COSS that she had heard was completed a year and one-half earlier, Ms. Frazier lied to her. Ms. Frazier told Councilmember Kehoe (through Christine Ruess, then-Rate Water Analyst) that the COSS "did not justify changing the rate structure," and that the purpose of the COSS was "to simply justify our existing structure [and] to make sure that we were complying with Prop 218."⁸⁹⁵

Patricia Frazier did not act alone in misleading City Council members. Less than a month before Councilmember Kehoe inquired about the COSS, George Loveland distributed the Pinnacle COSS, but falsely advised the Mayor and Council in the transmittal memo as follows: "Our conclusion, based on the studies and extensive internal review, was and is that the . . . sewer rate structures adopted by the Council are both business-friendly and consistent with the requirements of Proposition 218. This being the case, no

⁸⁹² Although Councilmember Peters did not attend the January 29, 2002 closed session and is not responsible for the continuing legal violations from January 2002 until November 2002, he received Kelly Salt's memorandum to the City Council on November 14, 2002, and is therefore ascribed with knowledge and responsibility for the City's continuing violations of law from that point forward.

⁸⁹³ Memorandum from Patricia T. Frazier, Financial and Technical Services Manager, to Coleman Conrad, Deputy City Manager (July 3, 1997).

⁸⁹⁴ City of San Diego Cost-of-Service Report Prepared for City of San Diego Financing Services by PinnacleOne at 2 (May 14, 1998).

⁸⁹⁵ E-mail from Christine Ruess to Dennis Kahlie (Oct. 20, 1999).

changes are needed or recommended at this time.”⁸⁹⁶ The cover memorandum was plainly contradicted by the content of the COSS. Mr. Loveland said that he had discussed the memo with Mr. Uberuaga before it was sent.⁸⁹⁷ Although this is the only evidence that Mr. Uberuaga was involved in misleading the City Council about the Pinnacle COSS (he was unwilling to be interviewed), it is difficult to believe that both Ms. Frazier and Mr. Loveland would have lied to the City Council without Mr. Uberuaga’s knowledge and approval.

By January 2002, through their response to Mr. Kahlie’s January 2002 presentation and again by removing the matter from their agenda altogether in November 2002, the Mayor and City Council had made it known that they were not receptive to the idea of changing the rate structure. They maintained that position even though they had had sole authority to change the sewer rate structure to bring the City into compliance with its legal obligations. To her credit, Ms. Frazier directed Mr. Kahlie to prepare his Salient Points Memo to brief the Mayor, in what could only be viewed as an effort to persuade the Mayor of the need to change the rate structure. Nonetheless, it was not until Fall 2003, after the City received the State’s noncompliance letter, that Ms. Frazier, Mr. Loveland or Mr. Uberuaga took steps to remind the elected officials of the need to change the rate structure. In the meantime, Mr. Loveland committed several additional misleading acts. When Councilmember Frye inquired during a May 2002 open session as to the status of the sewer COSS, Mr. Loveland made no effort to disclose the existence of a sewer COSS, and simply confirmed that a water COSS was underway.⁸⁹⁸ And, most significantly, Mr. Loveland signed loan agreements with the State which falsely represented that the City’s user charge system complied with the Clean Water Act and applicable federal and state laws and guidelines.⁸⁹⁹ Ms. Frazier and Mr. Loveland intentionally misrepresented information to the Council, which contributed to the City’s prolonged violation of the Clean Water Act.

⁸⁹⁶ Memorandum from George Loveland, Deputy City Manager, to Honorable Mayor and City Council (Oct. 6, 1999).

⁸⁹⁷ Interview by the Audit Committee with George Loveland (Oct. 19, 2005).

⁸⁹⁸ Videotape, San Diego City Council Budget Hearing (May 14, 2002).

⁸⁹⁹ San Diego Environmental Lab Project, Loan No. C-06-4703-110 (approved Feb. 26, 2003); Memorandum from George Loveland, Deputy City Manager, to Honorable Mayor and City Council (Oct. 6, 1999); Interview by the Audit Committee with George Loveland (Oct. 19, 2005).